

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
HERINGTON MUNICIPAL HOSPITAL
JUNE 30, 2015 AND 2014

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HERINGTON MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended June 30, 2015 and 2014

Our discussion and analysis of the financial performance of Herington Municipal Hospital provides a narrative overview of the Hospital's financial activities for the years ended June 30, 2015 and 2014. Please read it in conjunction with the accompanying financial statements.

Financial highlights

The Hospital reported an operating loss of \$148,607 in 2015, \$305,925 in 2014, and \$330,083 in 2013. After consideration of other nonoperating revenues and expenses and other contributions, grants, transfers, and gains, the Hospital's net position increased by \$129,872 or 12.4 percent in 2015 and decreased by \$57,210 or 5.2 percent in 2014.

Using these financial statements

The Hospital's financial statements consist of three statements - a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Net Position; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Hospital, and resources held by or for the benefit of the Hospital.

One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net position and changes in it. The Hospital's net position - the difference between assets and liabilities may be thought of as one way to measure the financial health, or financial position. Over time, increases or decreases in the Hospital's net position are one indicator of whether its financial health is improving or deteriorating. Consideration must also be given to other nonfinancial indicators, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Hospital.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. It provides answers to such questions as "Where did cash come from?", "What was cash used for?", and "What was the change in cash balance during the reporting period?"

HERINGTON MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended June 30, 2015 and 2014

Assets, liabilities, and net position

Table 1 below summarizes the Hospital's assets, liabilities, and net position for the latest three fiscal years.

Table 1: Assets, Liabilities, and Net Position

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Assets			
Current assets	\$ 1,780,944	\$ 1,542,678	\$ 1,279,741
Capital assets, net	1,140,997	735,928	808,530
Other noncurrent assets	<u>159,584</u>	<u>298,750</u>	<u>137,517</u>
Total assets	<u>3,081,525</u>	<u>2,577,356</u>	<u>2,225,788</u>
Liabilities			
Current liabilities	1,639,973	1,443,629	979,366
Noncurrent liabilities	<u>261,000</u>	<u>83,047</u>	<u>138,532</u>
Total liabilities	<u>1,900,973</u>	<u>1,526,676</u>	<u>1,117,898</u>
Net position			
Invested in capital assets, net of related debt	795,661	621,501	615,444
Expendable for capital acquisitions	7,500	150,000	11,218
Unrestricted	<u>377,391</u>	<u>279,179</u>	<u>481,228</u>
Total net position	<u>\$ 1,180,552</u>	<u>\$ 1,050,680</u>	<u>\$ 1,107,890</u>

Current assets increased in 2015 as compared to 2014 and 2013. The number of days of net revenue in net accounts receivable was 73, 58, and 50 days in 2015, 2014, and 2013, respectively. These balances will fluctuate depending on changes in collection personnel, third-party reimbursement rates, and revenue generated in the two months preceding year-end. Being designated as a critical access hospital, the Hospital is reimbursed for services rendered to Medicare patients on the basis of reasonable cost of providing services. These services are paid on an interim basis with final settlement determined through an annual cost report filed after the Hospital's year-end. In 2015, the Hospital recorded a net payable of \$40,607. This compares to a net payable of \$148,263 in 2014 and a net receivable of \$43,390 for 2013. The Hospital began participation in the 340B pharmacy program on April 1, 2014. Other receivables of \$97,968 and \$103,719 included on the statement of net position in 2015 and 2014, respectively, represent the net activity due to the Hospital from this program.

The Hospital's capital acquisitions, including assets purchased through capital leases, were \$571,190, \$66,017, and \$122,417 during 2015, 2014, and 2013. These capital assets were paid for primarily through donations received from the Herington Municipal Hospital Foundation or financed with capital lease obligations. Other changes in net capital assets result from the normal annual depreciation provisions of \$166,121, \$137,349, and \$145,268 during 2015, 2014, and 2013.

HERINGTON MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended June 30, 2015 and 2014

The Hospital made principal payments on long-term leases of \$233,196 in 2015, \$86,257 in 2014, and \$83,421 in 2013. In 2013, the City of Herington provided a grant of \$125,000 to the Hospital, which enabled the Hospital to increase its net position. As of June 30, 2015, the Hospital owes the City a total of \$134,998, of which \$20,000 is classified as long-term.

Other noncurrent assets consist primarily of board-designated funds that are available to fund the continuing operation of the Hospital and funds for the Hospital employees' self-funded health insurance. These funds decreased by \$196,833 in 2015, and increased by \$121,567 in 2014, both as compared with the previous year.

Current liabilities consist of balances accrued or currently due to suppliers, vendors, employees, and government agencies, related to operations and accrued interest on indebtedness and principal on indebtedness that will come due within one year. Accrued interest, accrued salaries and benefits, and accrued compensated absences fluctuate with operation and the timing of payments.

In 2014, accounts payable increased by \$302,535, and the current amount due to the City of Herington increased by \$79,256. In 2015, accounts payable increased by \$291,922, and the current amount due to the City of Herington decreased by \$26,963.

HERINGTON MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended June 30, 2015 and 2014

Operating results and changes in net position

In 2015, the Hospital's net position increased by \$129,872 or 12.4 percent. This change is made up of different components as displayed below in Table 2.

Table 2: Operating Results and Changes in Net Position

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Operating revenues			
Net patient service revenue	\$ 7,274,973	\$ 6,974,610	\$ 6,258,699
340B pharmacy revenue	895,694	187,143	
Other operating revenue	<u>51,328</u>	<u>91,503</u>	<u>97,441</u>
Total operating revenues	<u>8,221,995</u>	<u>7,253,256</u>	<u>6,356,140</u>
Operating expenses			
Salaries and wages	3,241,558	3,155,968	3,209,661
Employee benefits	883,778	780,231	693,549
Supplies and other	3,431,271	3,363,337	2,637,745
340B pharmacy expense	647,874	122,296	
Depreciation	<u>166,121</u>	<u>137,349</u>	<u>145,268</u>
Total operating expenses	<u>8,370,602</u>	<u>7,559,181</u>	<u>6,686,223</u>
Operating loss	(148,607)	(305,925)	(330,083)
Nonoperating expenses net of revenues	98,222	28,924	79,659
Tax revenues	115,447	19,769	19,000
Grant from City			125,000
Capital grants and contributions	<u>64,810</u>	<u>200,022</u>	<u>50,769</u>
Increase (decrease) in net position	<u>\$ 129,872</u>	<u>\$ (57,210)</u>	<u>\$ (55,655)</u>

The first component of the overall change in the Hospital's net position is its operating gain or loss - generally the difference between net patient service revenue and other operating revenues and the expenses incurred to generate those revenues. In 2015, the Hospital's operating loss was \$148,607, an improvement of \$157,318 from the Hospital's 2014 operating loss. In 2014, the Hospital's operating loss was \$305,925, which was an improvement of \$24,158 from its operating loss for 2013. The Hospital's net patient service revenue in 2015 increased \$300,363 or 4.3 percent. In 2014, net patient service revenue increased \$715,911 or 13.6 percent and, in 2013, increased by \$209,099 over the previous year. The change in net patient service revenue is affected by changes in charges to patients, payment rates by third-party payors, patient volumes, provision for bad debts, and the change in utilization by third-party payors. The increase in 2015 was driven by several factors. Inpatient days and outpatient services and revenues increased during 2015. Specific departments

HERINGTON MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended June 30, 2015 and 2014

that realized changes in gross revenue greater than 15 percent over 2014 include laboratory services, CT scan, and physical therapy services. The increase in CT scan revenues correlates with the Hospital's purchase of new CT scanner equipment during 2015. The Hospital also entered into the 340B pharmacy program effective April 1, 2014. Fiscal year 2014 included 3 months of activity and fiscal year 2015 included 12 months of activity.

Salaries, wages, and employee benefits totaled \$4,125,336, \$3,936,199, and \$3,903,210 in 2015, 2014, and 2013. These amounts change based on the number of full-time equivalent employees, salary increases, changes to employee benefit cost inflation, and use of contract labor. Supplies and other expenses increased by 2.0 percent in 2015 after increasing by 27.5 percent in 2014 as compared to 2013. The increase in 2014 was primarily due to the outsourcing of therapy services to an outside contractor. The 340B pharmacy program expenses increased proportionately with the revenue due to the timing of the start of this program. The net contribution to operating income (loss) by the 340B pharmacy program was \$247,820 in 2015, which was a \$182,973 improvement over 2014 in which the Hospital realized net income of \$64,847.

Nonoperating revenues (expenses) include interest income, interest expense, and contributions and insurance proceeds. Interest expense increased slightly in 2015 and 2014 due to additional capital lease debt outstanding. The Hospital also realized revenues related to insurance proceeds of \$53,994 in 2015 that did not occur in 2014.

Other changes in net position include capital grants and contributions which totaled \$64,810, \$200,022, and \$50,769 in 2015, 2014, and 2013, respectively. In 2015 and 2014, the Hospital received total donations of \$85,581 and \$191,022 from the Foundation, respectively, for capital equipment acquisitions. In 2013, the Hospital received a grant of \$125,000 from the City, which resulted in an increase in net position of \$125,000. Total tax revenues also increased in 2015 with the implementation of the temporary sales tax which began on January 1, 2015.

Management is committed to growing patient revenues while at the same time controlling expenses necessary in providing those services. This strategy is highly dependent upon recruiting and retaining high quality physician and mid-level providers to our community. We are also closely monitoring our expenses and face many future challenges which include identifying funding for necessary medical technology upgrades, facility maintenance, and electronic health medical record technology. As our Hospital faces these funding challenges, we are also closely monitoring changes in the health care landscape, which includes transition of Medicaid to managed care, implementation of insurance coverage mandates by the Affordable Care Act, and reduced payments from Medicare for bad debts and sequestration cuts, and the potential further reduction in payments from not timely installing certified electronic health record technology. We appreciate the support that we receive from our community and employees as we face these many challenges. Our focus will continue to be on strategies which provide high quality care to the community we serve.

This financial report is designed to provide a general overview of the Hospital's finances and to discuss the significant changes in our financial statements. If you have any questions about the report or need additional financial information, contact the Administration Office at Herington Municipal Hospital, 100 East Helen, Herington, Kansas 67449.



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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Herington Municipal Hospital

We have audited the accompanying financial statements of the business-type activity and discretely presented component unit of Herington Municipal Hospital, a component unit of the City of Herington, Kansas, as of and for the years ended June 30, 2015 and 2014, which collectively comprise the Hospital's financial statements as listed in the table of contents, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activity and the discretely presented component unit of Herington Municipal Hospital as of June 30, 2015 and 2014, and the respective changes in net position and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other-Matters

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 1 through 5 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of the financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Wendling Noel Nelson & Johnson LLC
Topeka, Kansas
December 1, 2015

FINANCIAL STATEMENTS

HERINGTON MUNICIPAL HOSPITAL

STATEMENTS OF NET POSITION

June 30,

ASSETS

	2015		2014	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
CURRENT ASSETS				
Cash and cash equivalents	\$ 42,995	\$ 55,284	\$ 45,360	\$ 67,518
Assets limited as to use	9,000		43,000	
Patient accounts receivable, net	1,450,032		1,111,448	
Other receivables	97,968		103,719	
Estimated third-party payor settlements	5,065		38,291	
Inventories	138,457		129,121	
Prepaid expenses	37,427		71,739	
Total current assets	<u>1,780,944</u>	<u>55,284</u>	<u>1,542,678</u>	<u>67,518</u>
ASSETS LIMITED AS TO USE				
By Board of Trustees				
For capital assets	50,973		174,895	
For operations	35,000		60,000	
For health claims and benefits	11,593		59,504	
By donors		84,041		11,973
Total assets limited as to use	<u>97,566</u>	<u>84,041</u>	<u>294,399</u>	<u>11,973</u>
Less amounts required to meet current obligations	<u>9,000</u>		<u>43,000</u>	
	<u>88,566</u>	<u>84,041</u>	<u>251,399</u>	<u>11,973</u>
CAPITAL ASSETS, NET	<u>1,140,997</u>	<u>-</u>	<u>735,928</u>	<u>-</u>
OTHER ASSETS				
Other investments	<u>71,018</u>	<u>-</u>	<u>47,351</u>	<u>-</u>
Total assets	<u>\$ 3,081,525</u>	<u>\$ 139,325</u>	<u>\$ 2,577,356</u>	<u>\$ 79,491</u>

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET POSITION

	2015		2014	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
CURRENT LIABILITIES				
Current portion of long-term debt and capital lease obligations	\$ 104,336	\$ -	\$ 55,485	\$ -
Accounts payable	1,064,605		772,683	
Accrued salaries, wages, and benefits	173,241		194,775	
Due to City of Herington	114,998		141,961	
Accrued compensated absences	137,121		92,171	
Estimated third-party payor settlements	45,672		186,554	
Total current liabilities	<u>1,639,973</u>	<u>-</u>	<u>1,443,629</u>	<u>-</u>
LONG-TERM DEBT AND CAPITAL LEASES, net of current portion				
Capital lease obligations	241,000		63,047	
Due to City of Herington	20,000		20,000	
Total long-term liabilities	<u>261,000</u>	<u>-</u>	<u>83,047</u>	<u>-</u>
Total liabilities	<u>1,900,973</u>	<u>-</u>	<u>1,526,676</u>	<u>-</u>
NET POSITION				
Invested in capital assets, net of related debt	795,661		621,501	
Expendable for capital acquisitions	7,500	78,687	150,000	6,519
Expendable for operating activities		5,354		5,454
Unrestricted	377,391	55,284	279,179	67,518
Total net position	<u>1,180,552</u>	<u>139,325</u>	<u>1,050,680</u>	<u>79,491</u>
Total liabilities and net position	<u>\$ 3,081,525</u>	<u>\$ 139,325</u>	<u>\$ 2,577,356</u>	<u>\$ 79,491</u>

HERINGTON MUNICIPAL HOSPITAL
STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN NET POSITION
Year ended June 30,

	2015		2014	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
Operating revenues				
Net patient service revenue	\$ 7,274,973	\$ -	\$ 6,974,610	\$ -
Other	<u>947,022</u>	<u>148,194</u>	<u>278,646</u>	<u>165,839</u>
Total operating revenues	<u>8,221,995</u>	<u>148,194</u>	<u>7,253,256</u>	<u>165,839</u>
Operating expenses				
Salaries and wages	3,241,558		3,155,968	
Employee benefits	883,778		780,231	
Supplies and other	4,079,145	88,360	3,485,633	197,391
Depreciation and amortization	<u>166,121</u>		<u>137,349</u>	
Total operating expenses	<u>8,370,602</u>	<u>88,360</u>	<u>7,559,181</u>	<u>197,391</u>
Operating income (loss)	<u>(148,607)</u>	<u>59,834</u>	<u>(305,925)</u>	<u>(31,552)</u>
Nonoperating revenues and expenses				
Interest income	16,812		18,867	
Interest expense	(44,437)		(28,960)	
Tax revenues	115,447		19,769	
Contributions	44,208		29,486	
Insurance proceeds	53,994			
Gain on sale of equipment	<u>27,645</u>		<u>9,531</u>	
Total nonoperating revenues	<u>213,669</u>	<u>-</u>	<u>48,693</u>	<u>-</u>
Excess of revenues over expenses (expenses over revenues) before capital grants and contributions and transfers	65,062	59,834	(257,232)	(31,552)
Capital grants and contributions	<u>64,810</u>		<u>200,022</u>	
Increase (decrease) in net position	129,872	59,834	(57,210)	(31,552)
Net position, beginning of year	<u>1,050,680</u>	<u>79,491</u>	<u>1,107,890</u>	<u>111,043</u>
Net position, end of year	<u>\$ 1,180,552</u>	<u>\$ 139,325</u>	<u>\$ 1,050,680</u>	<u>\$ 79,491</u>

The accompanying notes are an integral part of these statements.

HERINGTON MUNICIPAL HOSPITAL

STATEMENTS OF CASH FLOWS

Year ended June 30,

	2015		2014	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
Cash flows from operating activities				
Receipts from and on behalf of patients	\$ 6,828,733	\$ -	\$ 6,916,960	\$ -
Payments to or on behalf of employees	(4,101,920)		(3,981,504)	
Payments for supplies and services	(3,789,210)	(88,360)	(3,101,721)	(197,391)
Other receipts and payments	<u>952,773</u>	<u>148,194</u>	<u>174,927</u>	<u>165,839</u>
Net cash provided (used) by operating activities	<u>(109,624)</u>	<u>59,834</u>	<u>8,662</u>	<u>(31,552)</u>
Cash flows from noncapital financing activities				
Interest paid	(32,694)		(20,277)	
Tax revenues	115,447		19,769	
Noncapital transfers and contributions	<u>44,208</u>		<u>29,486</u>	
Net cash provided by noncapital financing activities	<u>126,961</u>	<u>-</u>	<u>28,978</u>	<u>-</u>
Cash flows from capital and related financing activities				
Acquisition of capital assets	(111,190)		(66,017)	
Grants and contributions for capital	64,810		200,022	
Principal payments on long-term debt and capital lease obligations	(233,196)		(86,257)	
Interest paid on capital related debt	<u>(11,743)</u>		<u>(8,683)</u>	
Net cash provided (used) by capital and related financing activities	<u>(291,319)</u>	<u>-</u>	<u>39,065</u>	<u>-</u>
Cash flows from investing activities				
(Increase) decrease in assets limited as to use	196,833	(72,068)	(121,567)	32,970
Other investments	(23,667)		(23,436)	
Interest received	16,812		18,867	
Insurance proceeds or proceeds from sale of equipment	<u>81,639</u>		<u>10,801</u>	
Net cash provided (used) by investing activities	<u>271,617</u>	<u>(72,068)</u>	<u>(115,335)</u>	<u>32,970</u>
Change in cash and cash equivalents	(2,365)	(12,234)	(38,630)	1,418
Cash and cash equivalents at beginning of year	<u>45,360</u>	<u>67,518</u>	<u>83,990</u>	<u>66,100</u>
Cash and cash equivalents at end of year	<u>\$ 42,995</u>	<u>\$ 55,284</u>	<u>\$ 45,360</u>	<u>\$ 67,518</u>

The accompanying notes are an integral part of these statements.

HERINGTON MUNICIPAL HOSPITAL
STATEMENTS OF CASH FLOWS - CONTINUED
Year ended June 30,

	2015		2014	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities				
Operating income (loss)	\$ (148,607)	\$ 59,834	\$ (305,925)	\$ (31,552)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities				
Depreciation	166,121		137,349	
Provision for bad debts	506,351		432,727	
Changes in				
Patient accounts receivable	(844,935)		(682,030)	
Other receivables	5,751		(103,719)	
Inventories and prepaid expenses	24,976		2,121	
Accounts payable and accrued expenses	288,375		336,486	
Estimated third-party payor settlements	(107,656)		191,653	
Net cash provided (used) by operating activities	<u>\$ (109,624)</u>	<u>\$ 59,834</u>	<u>\$ 8,662</u>	<u>\$ (31,552)</u>

Supplemental schedule of noncash investing and financing activities

The Hospital entered into a capital lease obligation for equipment totaling \$460,000 during 2015. No capital leases were entered into in 2014.

The accompanying notes are an integral part of these statements.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
June 30, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES

1. Reporting entity

Herington Municipal Hospital (Hospital), a political subdivision of the State of Kansas, is located in Herington, Kansas, and was organized for the purpose of providing inpatient and outpatient health care services to patients. The Hospital is governed by a five-member Board of Trustees elected by the voters of the City. The Hospital can sue and be sued, and can buy, sell, or lease real property. Bond issuances must be approved by the City. The Hospital is a discretely presented component unit of the City of Herington, Kansas, for financial statement purposes. The Hospital is licensed as a Critical Access Hospital (CAH) with a bed capacity of 25 beds.

2. Component unit

The financial statements include the financial data of the discretely presented component unit, Herington Municipal Hospital Foundation (Foundation). The component unit is reported separately to emphasize that it is legally separate from the Hospital.

The Foundation is recognized by the Internal Revenue Service as a 501(c)(3) Corporation, incorporated in the State of Kansas on August 7, 2001. The Foundation was originally formed for the purpose of acquiring a long-term care unit. In 2006, the name was changed to Herington Municipal Hospital Foundation. The Foundation was established as a public charitable foundation with the mission of raising funds for the Hospital. The Foundation is administered by a self-perpetuating Board of Directors which is appointed by the Hospital who is the sole member of the Foundation.

3. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

4. Basis of accounting

The Hospital's financial statements are comprised solely of an enterprise fund that uses proprietary fund accounting. The Hospital utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis using the economic resources measurement focus.

5. Cash and cash equivalents

Cash and cash equivalents include all cash and highly-liquid debt instruments purchased with a maturity of three months or less, excluding any such amounts included in assets limited as to use.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

6. Allowance for uncollectible accounts

The Hospital provides for accounts receivable that could become uncollectible in the future by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. The Hospital estimates this allowance based on the aging of its accounts receivable and its historical collection experience.

7. Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

8. Assets limited as to use

Assets limited as to use include cash set aside by the Board of Trustees for purchase of capital assets and for payment of self-insured health claims, over which the Board retains control and may at its discretion subsequently use for other purposes; and cash restricted as to use by donors.

9. Capital assets

Capital assets (including assets recorded as capital leases) are stated at cost. Depreciation and amortization of capital assets are provided on the straight-line method over the estimated useful lives of the assets. The estimated lives used are substantially in conformity with useful life guidelines established by the American Hospital Association.

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals, and betterments to depreciable properties are capitalized and depreciated over the remaining or extended estimated useful lives of the items or the properties. Gains and losses on disposition of capital assets are included in nonoperating revenues and expenses.

10. Other investments

The Hospital's investment in Community Holdings LLC (see Note I) is stated at cost.

11. Accrued compensated absences

Employees of the Hospital are entitled to paid vacation depending on length of service and whether they are full or part time. Upon resignation, termination, or retirement from service with the Hospital, employees are entitled to payment for all accrued vacation, up to an allowable maximum. The Hospital accrues vacation benefits as earned.

12. Accrued health insurance claims

The Hospital is self-insured for health insurance claims of its employees. Management estimates the net liability for reported and unreported claims incurred as of the end of each reporting period. The estimate is based on known claims and historical claims experience.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

Although management believes the estimate for accrued health insurance claims is reasonable, it is possible that actual incurred claims expense may vary from the estimate.

13. Net position

Net position of the Hospital is classified in three components. "Net position invested in capital assets net of related debt" consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted expendable net position" consists of noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital. "Unrestricted net position" is remaining net position that does not meet the definition of "invested in capital assets net of related debt" or "restricted expendable net position."

14. Operating revenues and expenses

The Hospital's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is the Hospital's principal activity. Nonexchange revenues, including noncapital grants and contributions and tax appropriations, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

15. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, contractual adjustments, and provision for bad debts, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

16. Charity care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The identified amount of charges forgone for services and supplies furnished under the Hospital's charity care policy is disclosed in Note B.

17. Income taxes

The Hospital is exempt from federal income taxes pursuant to Section 115 of the Internal Revenue Code.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

18. Subsequent events

The Hospital's management has evaluated all subsequent events through the date of the independent certified public accountant's report, which is the date the financial statements were available to be issued. See Note G for the line of credit entered into after the end of the year.

19. Reclassifications

Certain reclassifications have been made to the 2014 financial statements to conform with the 2015 presentation. These reclassifications did not change previously reported change in net position or ending net position.

NOTE B - NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established charge rates. The amounts reported on the statement of net position as estimated third-party payor settlements consist of the estimated differences between the contractual amounts for providing covered services and the interim payments received for those services. A summary of the payment arrangements with major third-party payors follows:

Medicare - The Hospital is a critical access hospital for purposes of the Medicare program and is paid for services rendered to Medicare beneficiaries under various cost reimbursement methodologies. The Hospital is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits or reviews thereof by the Medicare administrative contractor. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Hospital's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through June 30, 2013.

Medicaid - Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. All other services rendered to Medicaid beneficiaries are paid at prospective rates determined on either a per diem or a fee-for-service basis and are not subject to retroactive adjustment.

Blue Cross and Blue Shield - All services rendered to patients who are insured by Blue Cross and Blue Shield are paid on the basis of prospectively determined rates per discharge or discounts from established charges.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE B - NET PATIENT SERVICE REVENUE - Continued

The Hospital has also entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

A summary of gross and net patient service revenue follows:

	<u>2015</u>	<u>2014</u>
Gross patient service revenue		
Inpatient	\$ 2,970,990	\$ 2,718,597
Outpatient	7,375,574	6,950,508
Physician services	511,065	506,854
Rural health clinic	<u>603,458</u>	<u>554,842</u>
	11,461,087	10,730,801
Contractual adjustments	(3,555,079)	(3,206,241)
Discounts	(37,700)	(92,622)
Charity care	(86,984)	(24,601)
Provision for bad debts	<u>(506,351)</u>	<u>(432,727)</u>
Net patient service revenue	<u>\$ 7,274,973</u>	<u>\$ 6,974,610</u>

Revenue from the Medicare and Medicaid programs accounted for approximately 66 percent and 4 percent, respectively, of the Hospital's net patient service revenue during 2015, and 60 percent and 5 percent, respectively, of the Hospital's net patient service revenue during 2014. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

The Hospital maintains records to identify and monitor the level of charity care it provides. The amount of charges forgone for services and supplies furnished under its charity care policy for 2015 and 2014 was \$86,984 and \$24,601, respectively. The Hospital estimates that the cost of providing charity care, based on an overall ratio of cost-to-charges, was \$58,784 and \$16,653, respectively.

NOTE C - DEPOSITS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize the Hospital, with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, U.S. Treasury bills and notes, and the State Treasurer's investment pool. Kansas statutes also require that collateral be pledged and deposited with designated depositories for bank deposits with a fair market value equal to 100 percent of the uninsured amounts, and must be assigned for the benefit of the Hospital.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE C - DEPOSITS WITH FINANCIAL INSTITUTIONS - Continued

At June 30, 2015, the carrying amount of the Hospital's bank deposits was \$140,341 and the bank balances were \$147,815. The bank balances are covered by federal depository insurance or pledged securities, which are held in the name of the financial institution and pledged on behalf of the Hospital.

The Hospital's bank deposits are included in the financial statements under the following categories:

Cash	\$ 42,775
Assets limited as to use	<u>97,566</u>
Total bank deposits	<u>\$ 140,341</u>

NOTE D - PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable consist of the following:

	<u>2015</u>	<u>2014</u>
Patient accounts receivable	\$ 2,902,309	\$ 1,969,135
Less		
Allowance for contractual adjustments	(796,101)	(424,296)
Allowance for uncollectible accounts	<u>(656,176)</u>	<u>(433,391)</u>
	<u>\$ 1,450,032</u>	<u>\$ 1,111,448</u>

The Hospital's allowance for uncollectible accounts on amounts due from patients was 75 percent and 66 percent of self-pay accounts receivable as of June 30, 2015 and 2014, respectively. The Hospital's net bad debt write-offs were \$283,566 and \$368,355 for the years ended June 30, 2015 and 2014, respectively. The Hospital did not change its charity care or uninsured discount policies during the years ended June 30, 2015 or 2014. The Hospital does not maintain a material allowance for uncollectible accounts from third-party payors, nor has it incurred any significant bad debt write-offs from third-party payors.

NOTE E - ASSETS LIMITED AS TO USE

Assets limited as to use, held by the Hospital and the Foundation, are carried at fair value and consist of cash.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE F - CAPITAL ASSETS

Capital asset additions, retirements, and balances are as follows:

	2015			
	<u>Beginning balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 26,813	\$ -	\$ -	\$ 26,813
Land improvements	49,603			49,603
Buildings	1,655,006	52,375	30,274	1,677,107
Fixed equipment	1,139,643	29,811		1,169,454
Movable equipment	<u>2,167,876</u>	<u>489,004</u>	<u>581,090</u>	<u>2,075,790</u>
Totals at historical cost	<u>5,038,941</u>	<u>571,190</u>	<u>611,364</u>	<u>4,998,767</u>
Less accumulated depreciation				
Land improvements	49,603			49,603
Buildings	1,316,508	35,046	30,274	1,321,280
Fixed equipment	978,080	20,936		999,016
Movable equipment	<u>1,958,822</u>	<u>110,139</u>	<u>581,090</u>	<u>1,487,871</u>
	<u>4,303,013</u>	<u>166,121</u>	<u>611,364</u>	<u>3,857,770</u>
Capital assets, net	<u>\$ 735,928</u>	<u>\$ 405,069</u>	<u>\$ -</u>	<u>\$ 1,140,997</u>

	2014			
	<u>Beginning balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 26,813	\$ -	\$ -	\$ 26,813
Land improvements	49,603			49,603
Buildings	1,596,739	58,267		1,655,006
Fixed equipment	1,139,643			1,139,643
Movable equipment	<u>2,223,436</u>	<u>7,750</u>	<u>63,310</u>	<u>2,167,876</u>
Totals at historical cost	<u>5,036,234</u>	<u>66,017</u>	<u>63,310</u>	<u>5,038,941</u>
Less accumulated depreciation				
Land improvements	49,603			49,603
Buildings	1,287,971	28,537		1,316,508
Fixed equipment	960,003	18,077		978,080
Movable equipment	<u>1,930,127</u>	<u>90,735</u>	<u>62,040</u>	<u>1,958,822</u>
	<u>4,227,704</u>	<u>137,349</u>	<u>62,040</u>	<u>4,303,013</u>
Capital assets, net	<u>\$ 808,530</u>	<u>\$ (71,332)</u>	<u>\$ 1,270</u>	<u>\$ 735,928</u>

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE F - CAPITAL ASSETS - Continued

Capital assets include the following property under capital leases at June 30:

	<u>2015</u>	<u>2014</u>
Equipment	\$ 723,498	\$ 263,498
Less accumulated amortization	<u>179,495</u>	<u>86,070</u>
	<u>\$ 544,003</u>	<u>\$ 177,428</u>

NOTE G - LONG-TERM DEBT AND CAPITAL LEASES

Long-term debt and capital lease obligations are summarized as follows:

	<u>2015</u>	<u>2014</u>
Noninterest bearing loan from the City of Herington	\$ 20,000	\$ 20,000
Capital lease obligations (3.8 percent to 5.0 percent)	<u>345,336</u>	<u>118,532</u>
	365,336	138,532
Less current portion	<u>104,336</u>	<u>55,485</u>
Noncurrent portion	<u>\$ 261,000</u>	<u>\$ 83,047</u>

The City of Herington loaned the Hospital \$20,000 during the fiscal year ended June 30, 2011.

Long-term debt activity for the years ended June 30, is as follows:

<u>2015</u>						
	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>	<u>Long-term portion</u>
Loan from City of Herington	\$ 20,000	\$ -	\$ -	\$ 20,000	\$ -	\$ 20,000
Capital leases	<u>118,532</u>	<u>460,000</u>	<u>(233,196)</u>	<u>345,336</u>	<u>104,336</u>	<u>241,000</u>
	<u>\$ 138,532</u>	<u>\$ 460,000</u>	<u>\$ (233,196)</u>	<u>\$ 365,336</u>	<u>\$ 104,336</u>	<u>\$ 261,000</u>
<u>2014</u>						
	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>	<u>Long-term portion</u>
Loan from City of Herington	\$ 20,000	\$ -	\$ -	\$ 20,000	\$ -	\$ 20,000
Capital leases	<u>204,789</u>	<u>-</u>	<u>(86,257)</u>	<u>118,532</u>	<u>55,485</u>	<u>63,047</u>
	<u>\$ 224,789</u>	<u>\$ -</u>	<u>\$ (86,257)</u>	<u>\$ 138,532</u>	<u>\$ 55,485</u>	<u>\$ 83,047</u>

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE G - LONG-TERM DEBT AND CAPITAL LEASES - Continued

The following is a yearly schedule of future minimum lease payments under capital lease obligations at June 30, 2015:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 104,336	\$ 14,434	\$ 118,770
2017	76,563	9,985	86,548
2018	63,380	6,628	70,008
2019	66,547	3,461	70,008
2020	<u>34,510</u>	<u>494</u>	<u>35,004</u>
Total minimum lease payments	<u>\$ 345,336</u>	<u>\$ 35,002</u>	<u>\$ 380,338</u>

The loan from the City of Herington has no scheduled repayment terms and is based on the Hospital's ability to repay.

On August 17, 2015, the Hospital opened a line of credit at the First National Bank of Hope for \$300,000, which is collateralized by the Hospital's accounts receivable.

NOTE H - PENSION PLAN

The Hospital maintains a defined contributory pension plan for all eligible employees. Eligibility is established by all employees 21 years of age or older who have completed 1,000 hours of service for the year. Employer and employee contributions are computed at the rate of 3.5 percent of annual employee compensation, respectively. Contributions to the plan made by employees vest immediately and contributions to the plan made by the Hospital vest based upon the plan's vesting schedule with all employer contributions fully vested after five years of service. The total cost of the plan for the years ended June 30, 2015 and 2014, was \$91,723 and \$95,805, respectively. The Hospital applied forfeiture credits of \$3,295 and \$2,380 towards the 2015 and 2014 employer's pension contributions, respectively. All funds contributed by the Hospital for terminated employees who are not vested are maintained by the pension trustee.

NOTE I - EMPLOYEE HEALTH INSURANCE CLAIMS

Effective January 1, 2013, the Hospital became self-insured for health insurance claims of its employees. The Hospital has reinsured a portion of its risk for such claims. The reinsurance arrangement covers annual claims in excess of \$25,000 for each covered individual. Covered employees also provide part of the funds to pay claims through monthly contributions at predetermined rates. The Hospital has retained a third-party administrator to process and settle claims. The Hospital reimburses the agent weekly for the amount of claims paid by the agent net of any amounts recovered by reinsurance.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE I - EMPLOYEE HEALTH INSURANCE CLAIMS - Continued

The following is a summary of the activity under this arrangement:

	<u>2015</u>	<u>2014</u>
Estimated employee health insurance claims payable at the beginning of the year	\$ 43,000	\$ 59,230
Provision for employer's share of incurred claims and reinsurance expense for the period, net of any reinsurance proceeds	464,880	352,618
Employee contributions	68,298	58,634
Payments made for claims and reinsurance	<u>(567,178)</u>	<u>(427,482)</u>
Estimated employee health insurance claims payable at the end of the year	<u>\$ 9,000</u>	<u>\$ 43,000</u>

The Hospital has an equity interest in Community Holdings LLC the company which provides individual stop-loss coverage for incurred claims in excess of \$25,000 for individual subscribers.

NOTE J - COMMITMENTS AND CONTINGENCIES

The Hospital has entered into a self-insured trust agreement with the Kansas Hospital Association, along with other qualified hospitals in the state of Kansas. The purpose of this trust is to purchase workers' compensation insurance for employees. To the extent the trust would be unable to meet its claims liabilities, members have, jointly and severally, agreed to pay for all claims. Management has assessed the financial condition of the trust and believes that the trust is sufficiently funded to meet its liabilities as they come due as of June 30, 2015. Management is also not aware of any intention by the trust to implement an assessment in the future for past funding shortages.

NOTE K- CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of patient accounts receivable from patients and third-party payors is summarized as follows:

	<u>2015</u>	<u>2014</u>
Medicare	38%	36%
Medicaid	3	4
Blue Cross	11	11
Commercial	17	16
Self-pay	<u>31</u>	<u>33</u>
	<u>100%</u>	<u>100%</u>

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE L - RISK MANAGEMENT

The Hospital is insured for professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. The Hospital is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$300,000 pursuant to any one judgment or settlement against the Hospital for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$900,000. All coverage is on a claims-made basis. The above policies were renewed for the policy period from June 30, 2015 to June 30, 2016. Management is not aware of any open asserted claims as of June 30, 2015. It is possible that other claims may be asserted arising from past services provided.

In addition to the risk disclosed elsewhere in these financial statements and notes thereto, the Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Hospital purchases commercial insurance for these risks. Settled claims have not exceeded this commercial coverage in any of the past three years.

NOTE M - RELATED PARTY TRANSACTIONS

The Hospital purchases utilities from the City of Herington and recognized total expense of \$149,719 and \$121,297, respectively, during the years ended June 30, 2015 and 2014. As of June 30, 2015 and 2014, the Hospital owed the City of Herington a total of \$134,998 and \$161,961, respectively. A liability of \$114,998 and \$141,961 is reflected on the statement of net position as a current liability due to the City of Herington and \$20,000 is reflected as long-term debt in both years.

The Hospital receives property tax revenues from the City and recognized revenues of \$8,373 and \$19,769, respectively, in 2015 and 2014. Beginning on January 1, 2015, the City began collecting sales tax on behalf of the Hospital. At June 30, 2015, the Hospital has recorded a receivable for sales taxes collected in the amount of \$55,301. Sales tax revenues recognized for the year ended June 30, 2015, were \$107,074.

Herington Municipal Hospital Foundation is a component unit of the Hospital (see Note A2). The Foundation periodically transfers funds to the Hospital to support the Hospital's mission. During 2015 and 2014, the Foundation transferred \$85,581 and \$191,022, respectively, to the Hospital for the purchase of equipment or capital improvements to the building.

NOTE N - REALIZATION OF ASSETS

The Hospital had 6 days of cash expenses on hand at June 30, 2015, and has operated with low cash liquidity over the past several years. The Hospital's operations have reported losses of \$148,607 and \$305,925 for the years ended June 30, 2015 and 2014, respectively. Net position increased by \$129,872 to \$1,180,552 in 2015.

HERINGTON MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - CONTINUED
June 30, 2015 and 2014

NOTE N - REALIZATION OF ASSETS - Continued

Current economic conditions and the regulatory landscape for health care providers present many challenges. These challenges can affect the fair value of assets and provide additional constraints on liquidity primarily in the collection of receivables.

Management is aware of the need to improve the Hospital's liquidity and to stabilize operations and believe that progress was made in 2015. The City of Herington voters approved a one percent sales tax for hospital operations which went into effect on January 1, 2015. This tax is expected to generate approximately \$200,000 in annual receipts for the Hospital. Management believes that its actions will enable the Hospital to generate sufficient cash flows in the upcoming year to sustain operations.